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Crowdfunding Investments Could Be Risky

Department of Financial Institutions Warns of Potential Scams

FRANKFORT, Ky. – (Nov. 8, 2012) – Would you like to help a local business or start-up entrepreneur gain its first foothold in the community? What if after you invested, that business never produced its promised goods or services, and you were left holding a worthless share?

This is the concern that state securities regulators, including the Kentucky Department of Financial Institutions (DFI), have with the potential of crowdfunding as an investment.

Crowdfunding is an online money-raising strategy that began as a way for the public to donate small amounts of money, often through social networking websites, to help artists, musicians, filmmakers and other creative people finance their projects. The concept has recently been promoted as a way of assisting small businesses and startups looking for investment capital to help get their business ventures off the ground.

"The DFI supports economic development of all varieties, including startup businesses," said DFI Commissioner Charles Vice. "But, also, we are charged with protecting investors, and we see crowdfunding as a potential way for scam artists to enter an emerging market. We want to make sure investors are informed about what they are purchasing."

New federal legislation – the JOBS Act, which was signed into law in April –has directed the Securities and Exchange Commission to write rules that will change how business owners can raise capital online. Once these regulations are finalized in 2013, businesses and entrepreneurs will be able to raise up to $1 million in startup money by selling investments in the company through Internet portals. **Crowdfunding investments cannot be offered legally until the SEC adopts rules to permit them.** Investors should beware of offerings that seek investments immediately. Also, state regulators will not be allowed to review crowdfunding issuers or their offerings.

"Crowdfunding issuers will have to make some kind of disclosure to the investor. But we are concerned about how full and complete the disclosure information may be," said DFI Securities Division Director Shonita Bossier. "We want Kentucky investors to be able to make informed decisions about any investment they are considering. And we want investors be aware that startup companies are risky investments by nature, and that it may be difficult to resell these securities later without a secondary market."

All investments have risk, but small business investments may have even greater risk than normal. About 50 percent of all small businesses fail within the first five years.

If the crowdfunding investment does not perform as represented, the investor may have limited legal ability to take action against the issuer, and may be left to pursue costly private lawsuits if things go wrong. And while suspected fraud can always be reported to state securities regulators, such as DFI, often the con artist has spent the investors' money before it can be recovered.

There are no guarantees in investing. It is important to research investments and make sure there is an understanding of the terms, products and risk involved. Also, make sure the investment and the person selling it are licensed or registered in Kentucky. To check, call DFI's Securities Division at 800-223-2579 or visit http://kfi.ky.gov/public/Pages/invest.aspx.The same phone number and website can be used to report suspected fraud.

DFI, which traces its origin to the Banking Act of 1912, is an agency in the Public Protection Cabinet. For 100 years it has supervised the financial services industry by examining, chartering, licensing and registering various financial institutions, securities firms and professionals operating in Kentucky. DFI's mission is to serve Kentucky residents and protect their financial interests by maintaining a stable financial industry, continuing effective and efficient regulatory oversight, promoting consumer confidence, and encouraging economic opportunities.

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